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# Out on a Rim: *Pacific Rim's* Venture Into CAFTA's Denial of Benefits Clause

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## Out on a Rim: *Pacific Rim*'s Venture Into CAFTA's Denial of Benefits Clause

Jordan Behlman\*

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### I. BACKGROUND

With the rise of decolonization after the Second World War, many developed countries entered into international investment agreements, such as bilateral investment treaties ("BITs"), in order to protect themselves from uncompensated nationalization and expropriation of property from newly independent countries, due to colonialism's long history and debilitating political, social, and economic effects on their population.<sup>1</sup> Simultaneously, newly independent developing nations sought foreign direct investment to stimulate their respective economies.<sup>2</sup> These BITs, though still providing for espousal of claims and diplomatic protection, created standing for an investor to directly bring a claim against a state

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1. Kenneth J. Vandeveld, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT'L L. & POL'Y 157, 168 (2005); see also Rudolf Dolzer & Christoph Schreuer, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW*, 1 (Oxford Univ. Press 2008); T.W. Walde, *International Investment Law: An Overview of Key Concepts and Methodology*, 4:4 TRANSNATIONAL DISPUTE MANAGEMENT (TDM) 3 (July 2007).

2. Vandeveld, *supra* note 1, at 171.

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by creating a private right of action.<sup>3</sup> Investment treaties also helped reconcile the risks assumed by developed countries with the fairness and transparency expected by developing countries.<sup>4</sup>

While there was initially some hesitation by newly independent nations due to fears of neocolonialism,<sup>5</sup> the advent of the debt crisis in the 1980s made developing countries fixate on creating favorable investment conditions for developed countries.<sup>6</sup> While developing countries attracted investment, developed countries expected security for those investments. Consequently, the number of international investment agreements dramatically increased in the 1980s and 1990s.<sup>7</sup> Between 1959 and 1989, there were fewer than 400 BITs, but over the next fifteen years, there were approximately 2,000.<sup>8</sup> With an astounding number of BITs—not to mention the growth of multilateral investment treaties, and bilateral and multilateral free trade agreements—host countries became concerned with the growth of “treaty shopping” in the international community. Developing countries, therefore, needed to determine whether foreign investors had a sufficient connection to the treaty under which they sought protection and redress.<sup>9</sup> This became increasingly important as nationality became more fluid and as the world became, and continues to become, more globalized.

Although the international community experienced a large increase in the number of international investment agreements in the 1980s and 1990s, discussion of the denial of benefits clause (“DOB clause”) can be traced back to the 1950s.<sup>10</sup> In 1956, Herman Walker Jr. noted, “The recent treaties signed by the United States, at any rate, indicate that this possibility of a ‘free ride’ by third-country interests is one to be guarded against . . .”<sup>11</sup> This

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3. *Id.* at 175.

4. ZACHARY DOUGLAS, *THE INTERNATIONAL LAW OF INVESTMENT CLAIMS*, 2 (Cambridge Univ. Press 2009).

5. Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *Int'l L.* 655, 659–60 (1990). Developing countries began to demand a New International Economic Order that rejected that customary international law required host countries to uphold a minimum standard of protection to foreign investors.

6. Vandevelde, *supra* note 1, at 178.

7. *Id.* at 178–79.

8. *Id.* at 179.

9. Loukas A. Mistelis & Crina Mihaela Baltag, *Denial of Benefits and Article 17 of the Energy Charter Treaty*, 113:4 *PENN ST. L. REV.* 1301, 1303 (2009).

10. Herman Walker Jr., *Provisions on Companies in United State Commercial Treaties*, 50 *AM. J. INT'L L.* 373, 388 (1956).

11. *Id.*

concept of a “free ride” by third party nationals is exactly what the DOB clause seeks to prevent.<sup>12</sup> While this idea was raised in 1950s scholarship, it is more relevant today than ever.

Treaties include a DOB clause to prevent third parties from “treaty shopping”: the practice of multinational companies being structured to take advantage of favorable tax or dispute resolution benefits without actually assuming any obligations under a particular treaty.<sup>13</sup> The DOB clause, therefore, maintains reciprocity of benefits while excluding “shell companies” from receiving treaty protection.<sup>14</sup> Dolzer and Schruer suggest that while “treaty shopping” itself may not be “illegal or unethical,” states “may regard such practices as undesirable and take appropriate measures against them.”<sup>15</sup>

With increasing globalization, many states entered into multilateral investment treaties and BITs opted to include a DOB clause. For example, the 2012 Model U.S. BIT contains a DOB clause in Article 17.<sup>16</sup> Likewise, the Energy Charter Treaty (“ECT”) contains a clause entitled “Non-Application of Part III in Certain Circumstances.”<sup>17</sup> These DOB clauses, while similar in many ways, have important differences in context, wording, and effect.

Without a DOB clause, investors can access treaty benefits directly through the treaty or by importing more favorable provisions through the treaty’s Most-Favored Nation (“MFN”) clause. According to the International Law Commission, an MFN clause is “a treaty provision whereby a State undertakes an obligation towards another State to accord most-favored-nation treatment in an agreed sphere of relations.”<sup>18</sup> Essentially, the MFN clause prevents third-party states from receiving more preferential treatment than the contracting states. If other treaties contain provisions that are more favorable, parties are able to import those more favorable rights into the treaty.<sup>19</sup>

Thus, a DOB clause, in a way, seeks to limit the effect of the

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12. *Id.*

13. Mistelis & Baltag, *supra* note 9, at 1302.

14. *Id.*

15. Dolzer, *supra* note 1 at 55.

16. 2012 U.S. Model Bilateral Investment Treaty, art. 17, available at <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>.

17. Energy Charter Treaty, art. 17, Dec. 17, 1994, 2080 U.N.T.S. 95 (1995) [hereinafter *ECT*].

18. ‘Final Draft Articles on Most Favored Nation Clauses’ *YB of Int’l L. Commission* (Vol. 2, Pt. 2, 30th session, 1978) 16 (Art. 4).

19. Many Investor-State arbitral tribunals conflict over whether MFN clauses

MFN clause. It does so by denying certain treaty benefits to third parties that could be obtained by the presence of a MFN clause, but without the presence of a DOB provision. A DOB clause prevents third parties from raising claims under a treaty. Furthermore, a DOB clause also prevents contracting parties of one treaty from importing specific benefits from a comparator treaty. Normally, a third party would not have the right to gain any treaty protection.

Similar to other treaties, such as the ECT, the Dominican Republic – Central American Free Trade Agreement (“CAFTA”) includes a DOB clause. CAFTA parties have good reason to prevent treaty shopping and secure CAFTA’s benefits and obligations. Following the implementation of the North American Free Trade Agreement (“NAFTA”), many Central American countries sought to mirror the boost in foreign direct investment experienced by Mexico.<sup>20</sup> NAFTA, a trade and investment agreement among the United States, Canada, and Mexico, which was ratified in 1994, “aims at the free movement and liberalization of goods, services, people, and investments.”<sup>21</sup>

Mexico experienced increased foreign direct investment that inspired Central American countries.<sup>22</sup> For example, foreign direct investment to Mexico prior to NAFTA from 1991 to 1993 totaled \$12 billion. Fewer than ten years later, however, foreign direct investment to Mexico totaled \$54 billion.<sup>23</sup> From the standpoint of Central American countries, the expected benefits of CAFTA included “enhanced access to their largest export market, increased foreign direct investment, and institutional strengthening across a range of trade – and investment related areas.”<sup>24</sup> With only six countries party to CAFTA, it was essential to protect investment to encourage foreign direct investment from the dominant developed contracting state at the time: the United States.<sup>25</sup>

CAFTA, like many other multilateral treaties, contains a DOB clause to protect the contracting parties’ rights from “free-

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only apply to substantive rights (merits) or to procedural rights (dispute resolution) as well.

20. M. Ayhan Kose, Alessandro Rebucci, & Alfred Schipke, *Macroeconomic Implications of CAFTA-DR*, in CENTRAL AMERICA: GLOBAL INTEGRATION AND REGIONAL COOPERATION 17 (Markus Rodlauer & Alfred Schipke eds., 2005).

21. Dolzer, *supra* note 1 at 28.

22. Kose, *supra* note 20, at 17.

23. *Id.*

24. Dolzer, *supra* note 1, at 7.

25. See generally Dominican Republic – Central American Free Trade Agreement, Jan. 28, 2004, 43 I.L.M. 514 [hereinafter *CAFTA*].

riding” third parties.<sup>26</sup> The tribunal in *Pacific Rim Cayman LLC v. The Republic of El Salvador* (“*Pacific Rim*”)<sup>27</sup> analyzed the DOB clause solely by using the treaty interpretation principles of Article 31 of the Vienna Convention on the Law of Treaties (“VCLT”).<sup>28</sup> While both parties urged the tribunal to reference past tribunals’ treatment of the DOB clause under other treaties, such as the ECT, the tribunal refused because of CAFTA’s “different wording, context, and effect.”<sup>29</sup> *Pacific Rim* is the first tribunal to analyze CAFTA’s DOB clause.<sup>30</sup> It is the first, and only, instance where a tribunal has denied benefits to a claimant under CAFTA or NAFTA.<sup>31</sup>

*Pacific Rim* will be a highly influential case in DOB clause jurisprudence because the DOB interpretation in this case will likely have a significant impact on future tribunals’ understanding and interpretation of the CAFTA DOB clause. This is particularly true with regard to the United States. While tribunal decisions are not binding on other tribunals, future tribunals will turn to *Pacific Rim* when the DOB clause is invoked under CAFTA.

This comment’s purpose is twofold. First, it will show how,

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26. See generally *id.*

27. *Pacific Rim Cayman LLC v. The Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on the Respondent’s Jurisdictional Objections, ¶ 4.3 (June 1, 2012) [hereinafter *Pac Rim Jurisdiction Decision*].

28. Vienna Convention on the Law of Treaties, art. 31, May 23, 1969, 1155 U.N.T.S. 331 [hereinafter *VCLT*].

Article 31 General rule of interpretation 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty; (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty. 3. There shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation; (c) any relevant rules of international law applicable in the relations between the parties. 4. A special meaning shall be given to a term if it is established that the parties so intended.

29. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.3.

30. *Id.* ¶ 4.45.

31. *Id.* ¶ 4.3.

unlike previous tribunals' interpretations of the ECT's DOB clause, *Pacific Rim* correctly applied VCLT treaty interpretation principles by examining both the ordinary meaning of the text and the treaty's context. Second, this comment will show that the DOB clause, under the *Pacific Rim* analysis, is a proper and effective solution to unwanted and improper "treaty shopping" by foreign investors. Part II will analyze *Pacific Rim*'s treatment of the CAFTA DOB clause. It examines the facts of the case in relation to the DOB clause, and the manner in which the tribunal analyzed those facts retrospectively to define what constitutes "substantial business activities" and "own or control" under CAFTA. *Plama Consortium Limited v. Republic of Bulgaria* ("*Plama*"), unlike *Pacific Rim*, created the precedent that the ECT DOB clause could only be applied prospectively rather than retrospectively. Furthermore, *Plama* relegates the DOB clause analysis to the merits phase. *Pacific Rim*, however, takes a retroactive approach, allowing it to be a jurisdictional decision, which, I argue, is the more faithful application of the VCLT.<sup>32</sup>

In Part III, this comment compares the language and structure of the CAFTA and ECT DOB clauses. It illustrates how and why the CAFTA interpretation is more faithful to the treaty interpretation principles outlined in Article 31 of the VCLT.<sup>33</sup> This analysis will address the differences between the ECT and CAFTA DOB clause interpretation, such as jurisdictional limitations and the retrospective versus prospective effect, and will examine how these differences impact common language in the ECT and CAFTA, such as "substantial business activities," and the meaning of "own or control." Part IV discusses how *Pacific Rim*, unlike the recent ECT tribunals' analyses of the DOB clause, and the use of the MFN clause, provides a proper and effective solution to "treaty shopping." Last, Part V provides concluding thoughts on how *Pacific Rim* provides guidance to future tribunals that will wrestle with DOB clause application and interpretation under CAFTA and beyond.

## II. PACIFIC RIM'S TREATMENT OF THE DR-CAFTA DENIAL OF BENEFITS CLAUSE

As mentioned above, the *Pacific Rim* tribunal decided not to reference past tribunals' decisions under other treaties, such as

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32. See Generally *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (February 8, 2005) [hereinafter *Plama*].

33. VCLT, *supra* note 28, art. 31.

the ECT, due to “their different wording, context and effect.”<sup>34</sup> In other words, the tribunal relied solely on VCLT treaty interpretation principles to apply CAFTA to the facts of the case. To understand the tribunal’s interpretative process, one must first identify the facts relevant to the DOB clause analysis.

The claimant, Pacific Rim Cayman LLC (“Pac Rim”), a Nevada corporation, is wholly owned by Pacific Rim Mining Corporation (“PRMC”), a gold exploration company incorporated under Canadian law.<sup>35</sup> Pac Rim raised claims on behalf of two of its subsidiaries, Sociedad Anónima de Capital Variable and Dorado Exploraciones Sociedad Anónima de Capital Variable, both Salvadoran corporations,<sup>36</sup> against the Republic of El Salvador (“El Salvador”) for failing to grant exploitation permits in accordance with El Salvador’s laws.<sup>37</sup> The crux of the DOB claim, however, was Pac Rim’s corporate reorganization from the Cayman Islands to Nevada, United States.<sup>38</sup> Conveniently, the United States and El Salvador are contracting parties to CAFTA, whereas the Cayman Islands and Canada are not.<sup>39</sup>

El Salvador argued that it could deny CAFTA protection to Pac Rim because it did not have “substantial business activities” in the United States, nor was it “owned or controlled” by United States nationals.<sup>40</sup> As evident from the treaty provision itself, Pac Rim had to prove one of these two elements to be eligible for CAFTA protection:

Subject to Articles 18.3 (Notification and Provision of Information) and 20.4 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise.<sup>41</sup>

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34. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.3.

35. *Id.* ¶ 1.1.

36. *Id.* ¶ 1.2.

37. Krista Sceffey, *Pacific Rim v. El Salvador and the Perils of Free Trade in the Americas*, Council on Hemispheric Affairs (July 30, 2010), <http://www.coha.org/pacific-rim-v-el-salvador-and-the-perils-of-free-trade-in-the-americas/>.

38. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 1.3.

39. *See generally* CAFTA, *supra* note 25.

40. *Pacific Rim Cayman LLC v. The Republic of El Salvador*, ICSID Case No. ARB/09/12, The Republic of El Salvador’s Memorial Objections to Jurisdiction, ¶ 110 (October 15, 2010) 41–42 [hereinafter *Pac Rim El Salvador MOJ*].

41. CAFTA, *supra* note 25, art. 10.12(2).



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Thus, the first issue addressed by the tribunal was whether Pac Rim had “substantial business activities.”<sup>42</sup>

CAFTA, like many international investment agreements, does not define “substantial” in the treaty’s text.<sup>43</sup> For example, NAFTA Article 1113(2) states, in part, that “a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has *no substantial business activities . . .*” (emphasis added).<sup>44</sup> The ECT is another example of a major multilateral investment treaty that uses the “substantial business activities” language without providing a clear definition.<sup>45</sup> Faced with no definition of “substantial,” and guided by a faithful application of VCLT Article 31, the tribunal examined the facts in addition to Pac Rim’s own testimony in order to determine whether its business activities rose to the level of “substantial.”<sup>46</sup>

El Salvador relied heavily on Pac Rim’s affirmation that it was a holding company with no other purpose but to hold shares for its Canadian parent company.<sup>47</sup> Pac Rim had no office space, no employees, no board of directors, no United States bank account, and it conducted no exploration activities.<sup>48</sup> Moreover, Pac Rim did not pay any taxes in the United States.<sup>49</sup> El Salvador argued that Pac Rim did not rise to the level of a holding company, because it was simply a “shell company.”<sup>50</sup> To quote El Salvador, “A holding company, owned entirely by the parent company, with no operations, incorporated in a tax haven jurisdiction unrelated to the business, is the quintessential example of a *shell company*.” (emphasis included).<sup>51</sup>

El Salvador, in great detail, depicted Pac Rim as a shell company. On Pac Rim’s Nevada Business Registration form, it listed PRMC’s address and did not check a single box for business activity.<sup>52</sup> On its supplemental tax forms, Pac Rim checked boxes for

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42. *Pac Rim Jurisdictional Decision*, *supra* note 27, ¶¶ 4.63–4.78.

43. *See generally* CAFTA, *supra* note 25.

44. North American Free Trade Agreement (NAFTA), Dec. 17, 1992, 32 I.L.M. 289 (1993), art. 1113(2).

45. *ECT*, *supra* note 17, art. 17.

46. *Pac Rim Jurisdictional Decision*, *supra* note 27, ¶ 4.8.

47. *Id.*

48. *Id.*

49. *Id.*

50. *Pac Rim El Salvador MOJ*, *supra* note 40, ¶ 116.

51. *Id.*

52. *Id.* ¶ 130.

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“[c]orporation with no employees,”<sup>53</sup> and its lease information for the Nevada office provided PRMC’s Canadian address, and the office itself had the name “Pacific Rim Mining Corp.” posted above the door.<sup>54</sup> The two managers of Pac Rim were officers of PRMC, and all bank transfers by these officers went through PRMC itself.<sup>55</sup> El Salvador provided rich details to illustrate to the tribunal that no shred of evidence could define Pac Rim’s activities in the United States as “substantial.”

Pac Rim did not dispute any evidence, but instead adhered largely to the facts of the case by arguing that because Nevada was its principle place of business, and, therefore, the “nerve center” of its operations, Pac Rim had “substantial business activities” in the United States.<sup>56</sup> Moreover, it urged the tribunal to account for the “. . . activities of the corporate family as a whole.”<sup>57</sup> Thus, whether “in isolation or as part of the broader corporate group,” the tribunal should classify Pac Rim’s United States business activities as “substantial.”<sup>58</sup> Pac Rim wanted the tribunal to look beyond the activities of the claimant to the corporate group that was not a party to the arbitration.

Pac Rim asserted that Article 10.12.2 must be interpreted prospectively rather than retrospectively. It argued that the use of the present tense in the phrase “has substantial business activities” meant that El Salvador could not deny CAFTA benefits “simply because the investment preceded the establishment of substantial business activities.”<sup>59</sup> The activities must be analyzed from the moment El Salvador sought to deny benefits.<sup>60</sup> Pac Rim believed that this was the only interpretation that would promote the object and purpose of CAFTA to “substantially increase investment opportunities.”<sup>61</sup>

The tribunal used the ordinary meaning and context of CAFTA Article 10.12.2, and the object and purpose of the DOB clause and CAFTA to analyze the parties’ arguments.<sup>62</sup> Unlike

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53. *Id.* ¶¶ 128, 140.

54. *Id.* ¶ 140.

55. *Id.* ¶¶ 144, 170–71.

56. *Pacific Rim Cayman LLC v. The Republic of El Salvador*, ICSID Case No. ARB/09/12, Rejoinder on Respondent’s Objections to Jurisdiction, ¶¶ 150–53 (Mar. 2, 2011) [hereinafter *Pac Rim Rejoinder*].

57. *Id.* ¶ 147.

58. *Id.* ¶ 163.

59. *Id.* ¶ 160.

60. *Id.* ¶ 158.

61. *Id.*

62. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.61.

the analyses of other tribunals, which will be discussed below in later sections, *Pacific Rim* faithfully applied the VCLT Article 31 interpretative principles. CAFTA Article 2.1 defines an “enterprise” as “any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture, or other association.”<sup>63</sup> Thus, Pac Rim, not PRMC, was the enterprise in this case because it was the claimant. Based on the treaty’s definition of “enterprise,” and the context of the DOB clause itself, Pac Rim’s activities—not those of PRMC—must rise to “substantial.”<sup>64</sup> In the words of the tribunal, “[i]f that enterprise’s own activities do not reach the level stipulated by CAFTA Article 10.12.2, it cannot aggregate to itself the separate activities of other natural or legal persons to increase the level of its own activities for the purpose of applying CAFTA Article 10.12.2.”<sup>65</sup> This interpretation was conducive to both the ordinary meaning of the text and the context of the treaty as a whole.

Not only could Pac Rim not aggregate the activities of other enterprises, but the tribunal also refused to take a prospective approach to the ordinary meaning of Article 10.12.2. The question was not whether there would be “substantial business activities” arising from an investment, but whether “the claimant by itself had substantial business activities in the USA from 13 December 2007 onwards.”<sup>66</sup> In other words, did Pac Rim have “substantial business activities” starting from the date of the corporate reorganization from the Cayman Islands to Nevada? While Article 10.12.2 is written in the present tense, the tribunal chose to examine the DOB clause in the context of the treaty. How could a DOB clause be effective if past activities are not indicative of the status of the enterprise?

As discussed in the introduction, the purpose of a DOB clause is to prevent third parties from obtaining treaty benefits without assuming any treaty obligations.<sup>67</sup> To this end, it is essential that tribunals look retrospectively. As James Chalker suggests, a retrospective effect on a DOB clause encourages “investors to be upfront about ownership, control, nationality, and citizenship.”<sup>68</sup>

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63. CAFTA, *supra* note 25, art. 2.1.

64. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.66.

65. *Id.*

66. *Id.* ¶ 4.67.

67. Mistelis & Baltag, *supra* note 9, at 1302.

68. James Chalker, *Making the Energy Charter Treaty Too Investor Friendly*:

Chalker's argument can also be extended to "substantial business activities." To give proper effect to the CAFTA DOB clause, a contracting party must be able to examine whether "substantial business activities" existed at the time of the dispute and at the moment when the claimant requests arbitration. A prospective application, conversely, would eviscerate the DOB clause. It would give no effect to activities of an entity when a dispute arises, and it would provide no vantage point to evaluate whether an enterprise does in fact have "substantial business activities."

Given all the facts provided by El Salvador, and admitted by Pac Rim's testimony, the tribunal found that Pac Rim was merely a "passive actor."<sup>69</sup> Pac Rim's activities were associated with PRMC, not Pac Rim.<sup>70</sup> Moreover, these activities were directed at El Salvador, not the United States.<sup>71</sup> The tribunal concluded that "[Pac Rim] was and is not a traditional holding company actively holding shares in subsidiaries but more akin to a shell company with no geographical location for its nominal, passive, limited and insubstantial activities."<sup>72</sup>

The tribunal next turned to the second condition of the CAFTA DOB clause, which is whether Pac Rim was "owned or controlled" by persons of the United States.<sup>73</sup> While the wording of 10.12.2 requires that Pac Rim be owned *or* controlled by another CAFTA contracting party, El Salvador argued that Pac Rim satisfies neither condition.<sup>74</sup> Rather than being "owned or controlled" by United States nationals, El Salvador alleged that Pac Rim was owned *and* controlled by PRMC, a Canadian corporation.<sup>75</sup> Not only was PRMC "the sole member" of Pac Rim, but it was also its sole owner.<sup>76</sup> PRMC, as sole owner, appointed all of the Pac Rim's managers.<sup>77</sup> It was not United States shareholders, or Mr. Thomas C. Shrake ("Mr. Shrake"), President and CEO of PRMC, who owned or controlled Pac Rim, but rather PRMC, the Canadian parent company.

Pac Rim took an alternative approach to prove ownership *and*

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*Plama Consortium Limited v. the Republic of Bulgaria*, 3:5 TRANSNATIONAL DISPUTE MGMT 1, 17 (Dec. 2006) [hereinafter *Chalker*].

69. *Pac Jurisdiction Decision*, *supra* note 27, ¶ 4.68.

70. *Id.* ¶ 4.76.

71. *Id.* ¶ 4.74.

72. *Id.* ¶ 4.75.

73. *Id.* ¶ 4.11–4.16.

74. *CAFTA*, *supra* note 25, art. 10.12.2.

75. *Pac Rim El Salvador MOJ*, *supra* note 40, ¶ 110.

76. *Id.* ¶ 113.

77. *Id.*

control by United States nationals. It argued, “[t]he ultimate owners and controllers of [Pac Rim] are the U.S. persons who own a majority of the shares of the parent company.”<sup>78</sup> Furthermore, Mr. Shrake, a United States citizen and Nevada resident, “makes and implements key decisions for [Pac Rim] in his capacity as Manager, thereby steering [Pac Rim’s] fortunes and exercising control over the [Pac Rim].”<sup>79</sup> While this might not constitute direct ownership or control, it asserted that CAFTA’s definition of investment signifies that the ownership or control can be either direct or indirect.<sup>80</sup>

Given the facts, the tribunal again faithfully applied VCLT Article 31 by looking to the ordinary meaning of “ownership or control” in the context of the DOB clause and CAFTA in general. Regardless of whether a majority of Pac Rim’s shareholders reside in or have postal addresses in the United States, Pac Rim is still “owned and controlled” by its Canadian parent company, PRMC.<sup>81</sup> The tribunal dismissed the claimant’s argument that “agencies apply a rule of thumb whereby majority beneficial ownership by persons with addresses in the United States is considered to be majority beneficial ownership by U.S. citizens.”<sup>82</sup> Instead of using a “rule of thumb,”<sup>83</sup> the tribunal refers to the United States Immigration and Nationality Act for the definition of a United States national and found, “[p]ermanent allegiance to the USA cannot be met by adducing mere US postal addresses for shareholders in the Canadian parent company, even assuming them to be natural persons and however convenient or even appropriate for other domestic purposes. . . .”<sup>84</sup>

Even if the shareholders were legitimate United States nationals, PMRC, its parent company, owns and controls Pac Rim. The tribunal correctly determined that Pac Rim was, and is, a Canadian citizen. Because PRMC is not the claimant, there was no reason to look at the complex corporate structure of PRMC. The fact remained that PRMC wholly owned Pac Rim. The language and the context of the CAFTA DOB clause focus on the “enterprise.” This emphasis makes perfect sense in light of both the ordinary meaning of the language as well as the definition’s

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78. *Pac Rim Rejoinder*, *supra* note 56, ¶ 164.

79. *Id.*

80. *Id.* ¶ 169.

81. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶¶ 4.79-4.80.

82. *Id.* ¶¶ 4.16, 4.81.

83. *Id.* ¶ 4.16.

84. *Id.*

context in the CAFTA DOB clause. It is Pac Rim that requested arbitration, and, consequently, it must be Pac Rim, and not a third party, that must be evaluated under the treaty's terms and language.

Finally, the tribunal addressed the issue of timeliness. Unlike other DOB clauses, CAFTA Article 10.12.2 is subject to Article 18.3 and 20.4. Article 18.3 requires that one party must notify the other party "to the maximum extent possible" of any measure that "might materially affect the operation of this Agreement."<sup>85</sup> Article 20.4 allows any party to request consultation in writing relating to any measure that "might affect the operation of the Agreement."<sup>86</sup> El Salvador argued that it complied with both CAFTA provisions. Nowhere in Article 10.12.2 does the provision require a time constraint on the invocation of the DOB clause, or state that it must be invoked prior to the arbitration's commencement.<sup>87</sup> Rather, El Salvador provided timely notification because it was not notified that the claimant changed nationality in 2007 until June 16, 2008, due to an "unrelated query by the El Salvador's National Investment Office."<sup>88</sup> El Salvador was unable to complete its investigation into Pac Rim's nationality until it invoked the DOB clause on August 3, 2010.<sup>89</sup> With regard to Article 20.4, the tribunal found that the United States government never requested consultations, and only the United States government, not Pac Rim, would have had standing to make such a request.<sup>90</sup>

Pac Rim, however, argued that El Salvador did not comply with Article 18.3 and 20.4, and should be prevented from invoking the DOB clause.<sup>91</sup> Pac Rim claimed that El Salvador could have notified the United States "as early as June 2008,"<sup>92</sup> and that El Salvador should have notified Pac Rim of its intent to deny benefits prior to arbitration.<sup>93</sup> Pac Rim likens Article 20.4's consultation provision to a breach of diplomatic protection provided in the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States ("ICSID") Article 27.<sup>94</sup> Pac

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85. *CAFTA*, *supra* note 25, art. 18.3.

86. *Id.* art. 20.4.

87. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.20.

88. *Id.* ¶ 4.22.

89. *Id.* ¶ 4.25.

90. *Id.* ¶ 4.27.

91. *Id.* ¶ 4.40.

92. *Id.* ¶ 4.39.

93. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.40.

94. *Pac Rim Rejoinder*, *supra* note 56, ¶ 203.

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Rim argues that “[a] State may be considered to be giving diplomatic protection to its investor through measures that fall short of espousal.”<sup>95</sup> Pac Rim contends that El Salvador’s understanding of ICSID Convention Article 27 is too limited.<sup>96</sup>

While requiring notification and an opportunity for consultation by subjecting the clause to Article 18.3 and 20.4, the DOB clause does in fact specify when a state can deny benefits to an investor.<sup>97</sup> Because there is no specific time limit contained in Article 10.12.2,<sup>98</sup> and because Pac Rim elected ICSID arbitration, the *Pacific Rim* tribunal consulted ICSID Convention Article 41.<sup>99</sup> Article 41 states that any objection by a respondent that the dispute is not within its jurisdiction, or, for other reasons, is not within the competence of the tribunal, “shall be made as early as possible” and “no later than the expiration of the time limit fixed for the filing of the counter-memorial.”<sup>100</sup>

The *Pacific Rim* tribunal incorporated Article 41 into the CAFTA DOB clause. It agreed that El Salvador had timely invoked the DOB clause. In its opinion, “[i]t is not apparent. . . that [El Salvador] thereby deliberately sought or indeed gained any advantage over the claimant, by waiting until 1 March 2010 (as regards notification to the USA) or 3 August 2010 (for its invocation of the DOB clause to [Pac Rim]).”<sup>101</sup> Because no advantage was sought or gained, El Salvador properly and timely invoked the CAFTA DOB clause.

The *Pacific Rim* tribunal further agreed with El Salvador that CAFTA Articles 18.3 and 20.4 were not to be understood as diplomatic protection within the meaning of ICSID Convention Article 27. These provisions were not drafted to enable states to secure redress for international wrongful acts.<sup>102</sup> Instead, the provisions were informal diplomatic exchanges to facilitate settlement between the parties. In other words, the *Pacific Rim* tribunal envisioned Article 20.4 as a procedure that fell short of full diplomatic protection. These interpretative strategies were not addressed in the DOB clause. Rather, it looked to the context of

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95. *Id.*

96. *Id.*

97. *CAFTA*, *supra* note 25, art. 10.12.2.

98. *Id.*

99. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.81.

100. Convention on the Settlement of Investment Disputes between States and Nationals of Other States art. 41, Mar. 18, 1965, 17 U.S.T. 1270.

101. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.84.

102. *Id.* ¶ 4.88.

the treaty and the ICSID Convention to find an applicable standard that preserved the object and purpose of the treaty as well as the DOB clause.

The *Pacific Rim* tribunal's analysis takes a holistic approach to VCLT Article 31. Instead of focusing only on the ordinary meaning of the text, the tribunal accounts for the treaty's object and purpose, as well as its context, in its analysis. This approach effectuates the DOB clause's purpose and meaning. If a tribunal is to evaluate whether an enterprise has "substantial business activity" in a contracting state, or whether it is "owned or controlled" by nationals of a contracting state, it must examine these terms in relation to both the investor and the investment. If a party is to provide notification that it is invoking such a clause, it must be able to distinguish whether the claimant is eligible for treaty protection. In a globalized world where nationality has become fluid and where corporate reorganization is frequent, it is nonsensical to expect governments to track the corporate governance of all private investors engaged in long-term investments. Moreover, a state cannot predict which entity could potentially raise a claim. Identifying the claimant is crucial to assessing the benefits and obligations afforded to the investor and the investment. It is not possible for a host state to reasonably assess whether the claimant can claim treaty protection until after a dispute has led the parties to state their intentions to arbitrate.

### III. COMPARING THE LANGUAGE AND STRUCTURE OF THE CAFTA DOB CLAUSE

Although *Pacific Rim* was the first case to invoke the CAFTA DOB clause, many other tribunals have wrestled with DOB clauses from other treaties. Despite differences in context and wording, there are also many similarities between the CAFTA DOB clause and the DOB clauses in other treaties. To illustrate *Pacific Rim*'s distinct application of VCLT Article 31, it is useful to examine how other tribunals have interpreted the DOB clause in another treaty, such as the ECT. Because a tribunal has yet to struggle with NAFTA's DOB clause, the ECT provides a strong comparator treaty because, like CAFTA, it is a multilateral agreement.

Despite different contexts, the object and purpose of both CAFTA and the ECT is to promote foreign investment. The CAFTA preamble states that one of its primary purposes is to "contribute to the harmonious development and expansion of



world trade and provide a catalyst to broader international cooperation.”<sup>103</sup> Similarly, ECT Article 2 states that the treaty provides “a legal framework in order to promote long-term cooperation in the energy field, based on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.”<sup>104</sup> While CAFTA is focused on fostering cooperation among its contracting parties in world trade and foreign direct investment, the ECT is focused on strengthening investment and cooperation among its contracting parties in the energy sector.

While the object and purpose of CAFTA and ECT are relatively similar in that each treaty encourages cooperation in foreign investment, tribunals have interpreted the respective DOB clauses differently. Both treaties use the phrases “substantial business activities” and “own or control” as conditions precedent for granting or denying treaty benefits. While the *Pacific Rim* tribunal examined both the ordinary meaning and the context of the applicable treaty in its decision, the *Plama* tribunal only analyzed the ordinary meaning of the treaty provision, leaving the DOB clause with an absurd meaning as a merits-based question rather than as a jurisdictional safeguard. Consequently, the DOB clause was robbed of any substantive meaning.

#### A. *Jurisdictional Limitation*

Unlike in *Pacific Rim*, tribunals have interpreted the DOB clause from the ECT as providing no jurisdictional limitation.<sup>105</sup> In other words, a denial of benefits can only relate to a dispute’s merits. This conclusion is based on the provision’s ordinary meaning rather than the context of the treaty. ECT Article 17(1)’s heading and wording are drafted as follows:

#### **ARTICLE 17 NON-APPLICATION OF PART III IN CERTAIN CIRCUMSTANCES**

Each Contracting Party reserves the right to deny the advantages of this Part to: (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized.<sup>106</sup>

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103. *CAFTA*, *supra* note 25, Preamble.

104. *ECT*, *supra* note 17, art. 2.

105. Laurence Shore, *The Jurisdictional Problem in Energy Charter Treaty Claims*, 10 INT’L ARBITRATION L. REV. 1, 5 (2007) [hereinafter *Shore*].

106. *ECT*, *supra* note 17, art. 17.

Because the ECT's dispute resolution provision, Article 26, is located in Part V rather than Part III, tribunals have restricted Article 17's application to the substantive rights in the merits phase rather than procedural rights during the jurisdictional phase.

The *Plama* tribunal established a restrictive interpretation of ECT Article 17.<sup>107</sup> The tribunal only looked to the "ordinary meaning" of the language without placing it in its proper context as required by VCLT Article 31.<sup>108</sup> In *Plama*, a Cypriot company sued Bulgaria over the privatization of a state owned oil refinery. The claimant alleged that Bulgaria failed to create a stable investment environment. Because the heading is worded "Non-Application of Part III," and because the provision states, "deny the advantages of this Part. . ." the *Plama* tribunal decided that Article 26, the dispute settlement provision in Part V, was not applicable. The *Plama* tribunal claimed that "the language is unambiguous,"<sup>109</sup> and, therefore, "[T]he express terms of Article 17 refer to a denial of the advantages 'of this Part', thereby referring to the substantive advantages conferred upon an investor by Part III of the ECT."<sup>110</sup>

This restrictive analysis was affirmed in *Ltd. Liab. Co. AMTO v. Ukraine* ("AMTO") when the tribunal explained that the "claimant has the burden to prove that it satisfies the definition of an Investor so as to be entitled to Part III protections and the right to arbitrate disputes in Article 26."<sup>111</sup> While that may have been the "ordinary meaning" of the provision, the tribunal never considered whether that particular interpretation was appropriate within the general context of the treaty.

CAFTA, conversely, does not use limiting language in the construction of its DOB clause. CAFTA's Article 10.12 states the following:

#### **Article 10.12: Denial of Benefits**

1. A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if persons of a

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107. *Plama*, *supra* note 32, ¶ 147.

108. VCLT, *supra* note 28, art. 31.

109. *Plama*, *supra* note 32, ¶ 147.

110. *Id.*

111. *Ltd. Liab. Co. AMTO v. Ukraine*, SCC Arbitration No. 080/2005, Final Award, ¶ 64 (Mar. 28, 2008) [hereinafter *AMTO*].

non-Party own or control the enterprise and the denying Party:

(a) does not maintain diplomatic relations with the non-Party; or

(b) adopts or maintains measures with respect to the non-Party or a person of the non-Party that prohibit transactions with the enterprise or that would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.

2. Subject to Articles 18.3 (Notification and Provision of Information) and 20.4 (Consultations), a Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of any Party, other than the denying Party, and persons of a non-Party, or of the denying Party, own or control the enterprise.

The language applies to both Chapter 10 Section A, “Investment,” and Chapter 10 Section B, “Investor-State Dispute Settlement.”<sup>112</sup> It is also encouraging that both Section A and Section B are located in Chapter 10, while the ECT separates the two provisions into separate and distinct parts. Based on a systematic interpretation of CAFTA, this seems a suitable interpretation because the *Pacific Rim* tribunal applied a good-faith interpretation based on the ordinary meaning and the context of the treaty. Because both the ordinary meaning and the context of the language were not “manifestly absurd or unreasonable,” the *Pacific Rim* tribunal did not have to go beyond the provision’s language.<sup>113</sup> The language of the DOB clause, therefore, fits comfortably within the construction of the treaty.

Under the *Plama* and *AMTO* interpretations, however, the tribunals misapplied the VCLT by not looking beyond the ordinary meaning when the textual interpretation denied the DOB clause of any purpose and effect, and when the textual interpretation would be “manifestly absurd or unreasonable.”<sup>114</sup> The textual interpretation would be unreasonable because under these interpretations, the DOB clause would serve no purpose, and thus, would not fit into the treaty’s context. Consequently, the DOB clauses’ language had a direct effect on the *Plama* and *AMTO* tribunals’ interpretations of the treaty. Because the ordinary

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112. CAFTA, *supra* note 25, art. 10.

113. VCLT, *supra* note 28, art. 32.

114. *Id.*

meaning of the DOB clause was consistent with the treaty's context, *Pacific Rim* provided full effect to the DOB clause. When the ordinary meaning and the context were inconsistent, the DOB clause lost its purpose and effect. Just as bad facts can make bad law, poor drafting can lead to poor interpretation.

Despite arguing that its interpretation was consistent with the contextual meaning of the DOB clause,<sup>115</sup> *Plama's* analysis never moved beyond the ordinary meaning of the language. By solely focusing on the reference to Part III in the heading and text, the *Plama* tribunal ignored over fifty years of jurisprudence that has relied upon the principle that "standard practice has been to consider 'denial of benefits' as an objection that a host State can raise against diplomatic protection, and its successor, investment arbitration, against companies controlled from outside the treaty."<sup>116</sup> The *Plama* tribunal, therefore, should have examined the supplementary means of interpretation, because as specified in VCLT Article 32(b), *Plama's* DOB clause interpretation "leads to a result which is manifestly absurd or unreasonable."<sup>117</sup>

According to Thomas W. Walde, nothing in the *travaux* indicated a shift for denial of benefits practice, and thus "[t]he Part III reference in an interpretation of the context (Articles 26(1) – 17(1)) should be seen as nothing but a reminder that the denial of benefits, for example, raising a jurisdictional objection, only applied to the arbitrable (justiciable) Part III investment obligations."<sup>118</sup> Laurence Shore supports Walde's interpretation, and suggests, "[i]t is a perfectly plausible reading. . .to find that as Art. 17(1) relates so centrally to the Art. 26(1) requirements of investor status ("Investor of another Contracting Party") and a breach of Part III obligation, that it constitutes a jurisdictional considera-

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115. *Plama*, *supra* note 32, ¶ 147.

116. THOMAS W. WALDE, *Interpreting Investment Treaties: Experiences and Examples*, in INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY: ESSAYS IN HONOR OF CHRISTOPH SCHREUR 727 (Christina Binder et. al. eds., 2009) [hereinafter *Walde*].

117. VCLT, *supra* note 28, art. 32.

Article 32 Supplementary means of interpretation: Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable.

118. *Walde*, *supra* note 116, at 727.

tion for an arbitral tribunal.”<sup>119</sup>

Furthermore, in reference to the *Plama* tribunal, Chalker asserts that “[h]iding behind Article 31 (1) VCLT, the tribunal never answered the basic question of how there can be Article 26 ECT jurisdiction, which it recognizes as limited to Part II, if a respondent properly invokes Article 17 (1), which denies the investor any Part III protections.”<sup>120</sup> Unlike the interpretation in *Plama*, *Pacific Rim* gives jurisdictional effect to the DOB clause. After all, how is a host state to know which investors will file a claim, and which nationality the investor will have at the moment a claim is filed?

It is possible that if CAFTA’s DOB clause had been drafted similarly to the ECT’s DOB clause, the tribunal may also have limited its analysis to the ordinary meaning. However, because the ordinary meaning and context were consistent in *Pacific Rim*, one will never know how the interpretation would have changed if the provision were drafted differently. What is important to note is the effect that treaty language can have on a tribunal’s interpretative approach. The ordinary meaning may be important, but it is only one element of VCLT Article 31.<sup>121</sup> Article 31 is titled “General rule of interpretation,” and, therefore, should be read holistically as one single rule with various elements.<sup>122</sup> The rule of interpretation is that “a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”<sup>123</sup> It would seem from the outcomes that the tribunals in the ECT cases stopped reading VCLT Article 31 at “ordinary meaning” and forgot that such meaning shall be interpreted in light of the treaty’s context, object, and purpose.<sup>124</sup>

### *B. Retrospective or Prospective Effect*

Whereas the *Plama* tribunal granted a prospective effect to the DOB clause, the *Pacific Rim* tribunal applied the CAFTA DOB clause retrospectively. Only a retrospective effect provides a DOB clause with any significance. This retrospective versus prospective analysis is fundamental for interpreting when the DOB

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119. *Shore*, *supra* note 105, at 6.

120. *Chalker*, *supra* note 68, at 7.

121. VCLT, *supra* note 28, art. 32(1).

122. *Id.* (emphasis added).

123. *Id.*

124. *Id.*

clause is generally applied, and specifically in the evaluation of “substantial business activities” and “ownership or control.”

In *Plama*, the tribunal interpreted the phrase “reserves the right” as an existence of a right that must be exercised.<sup>125</sup> Because it is drafted in the present tense and the ECT is based on long-term cooperation, the tribunal argued that an investor would not be able to plan its investment if the DOB clause had a retrospective effect.<sup>126</sup> This interpretation was reinforced in *Yukos Universal Unlimited (Isle of Man) and The Russian Federation* (“*Yukos*”) when the tribunal decided that a “[r]etrospective application of a denial of rights would be inconsistent with such promotion and protection and constitute treatment at odds with those terms.”<sup>127</sup>

Consequently, *Plama* and *Yukos* are both pro-investor interpretations because the tribunals value the investor’s rights over those of the host state. Scholars are critical of the *Plama* and *Yukos* analyses. As Chalker explains, “[o]ne could argue that the retrospective effect of Article 17(1) would benefit ‘long-term cooperation’ by encouraging investors to be upfront about ownership, control, nationality, and citizenship.”<sup>128</sup> The *Pacific Rim* tribunal’s interpretation led to a balancing of interests between the investor and the host state. While the CAFTA DOB clause uses permissive language, “may deny the benefits of this chapter,”<sup>129</sup> and is drafted in the present tense, the context of the DOB clause could only properly be applied if the investor and the investment could be analyzed retroactively, thereby denying benefits after the fact. If a tribunal attaches a pro-investor interpretation to the DOB clause, it robs the provision of any real effect. After all, the clause’s purpose is to balance the rights of contracting states and investors so that only the proper investors of a contracting state receive treaty benefits. This is evidenced in the manner tribunals examine the DOB clauses’ conditions precedent of “substantial business activities” and “ownership and control.”

### C. “Substantial Business Activities”

As noted above, in analyzing whether a claimant had “substantial business activities” to justify the tribunal’s jurisdiction,

125. *Plama*, *supra* note 32, ¶ 155.

126. *Id.* ¶ 159.

127. *Yukos Universal Unlimited (Isle of Man) and The Russian Federation*, PCA Case No. AA 227, Interim Award on Jurisdiction and Admissibility, ¶ 458 (Nov. 30, 2009) [hereinafter *Yukos*].

128. Chalker, *supra* note 68, at 17.

129. CAFTA, *supra* note 25, at art. 10.12.

*Pacific Rim* applied the CAFTA DOB clause retrospectively. Conversely, by analyzing “substantial business activities” in the merits phase, tribunals such as *Plama*, *AMTO*, and *Yukos* applied the ECT DOB clause prospectively. The ECT tribunals, therefore, assumed that the claimants had “substantial business activities” to grant treaty benefits before determining whether the claimant actually had rights to those benefits. The question then becomes whether, at the time of the dispute, the claimants had “substantial business activities,” and not whether those activities were adequate for the claimant to be a *bona fide* investor under the treaty *ab initio*. *Plama* essentially “converted a jurisdictional challenge into a motion to dismiss.”<sup>130</sup> The *Plama* tribunal, as well as the subsequent ECT cases, accepted the claimant’s “substantial business activities” as true for jurisdictional purposes even though this assumption goes directly to whether the tribunal could have jurisdiction in the first place. This is the wrong approach because it does not provide a systematic analysis of all parts of the treaty and only goes to the ordinary meaning of the language.

To the *Pacific Rim* tribunal, however, “the relevant question [was] whether the claimant by itself had substantial activities in the USA from 13 December 2007 onwards.”<sup>131</sup> The tribunal was measuring the business activities of the claimant, not just from the initiation of arbitration, but from the date that the claimant was incorporated in the United States to determine whether it could exercise jurisdiction. *Pacific Rim* did not just assume that “substantial business activities” were met; it thoroughly examined such activities to determine the tribunal’s jurisdiction. Conversely, the *AMTO* tribunal was “satisfied that the [c]laimant has substantial business activity in Latvia, on the basis of its investment related activities conducted from the premises in Latvia, and involving the employment of a small but permanent staff.”<sup>132</sup> It is important to note that *Pacific Rim* evaluated whether the claimant *had*—rather than *has*—“substantial business activities.” The use of the past tense signifies that its analysis covers the entire history of the claimant’s activities since its incorporation in a contracting state, illustrating its jurisdictional significance. *AMTO* simply looked to the present in determining whether the claimant’s present activities rose to the level of “substantial.”

Ironically, despite using the present tense and relegating the

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130. *Shore*, *supra* note 105, at 1.

131. *Pac Rim Jurisdictional Decision*, *supra* note 27, ¶ 4.67.

132. *AMTO*, *supra* note 111, § 69.

DOB clause analysis to the merits phase, *AMTO* still looked retrospectively at the claimant's business activity. The *AMTO* tribunal notes that the claimant's office space was leased from 2000 to 2007, and that *AMTO*'s tax certificate showed tax payments throughout that seven-year time frame.<sup>133</sup> The tribunal conducted a retroactive analysis in order to apply the DOB clause prospectively but waited for the final award to engage in such interpretation. This approach adds further confusion to DOB clause jurisprudence. If a tribunal is going to evaluate the past activities and conduct of a claimant, how can this not be analyzed in light of whether a tribunal has jurisdiction and a claimant has any rights under the treaty?

Unlike *AMTO*, the *Pacific Rim* analysis is a reasonable application of the VCLT treaty interpretation principles because it takes a retrospective rather than prospective approach. It chose to examine not just current business activity, but also any and all of the claimant's business activity since it relocated in Nevada. The *Pacific Rim* tribunal also decided this issue in the jurisdictional phase as to not allow the tribunal to overstep its jurisdictional boundaries. This is important because *Pacific Rim* looked to whether "substantial business activity" existed before delving into the merits of the case to determine whether it should even reach that arbitral phase.

#### D. "Own or Control"

Just as in defining "substantial business activities," *Pacific Rim* correctly applied VCLT Article 31 to determine whether the claimant was "owned or controlled" by a national of a contracting state. Again, the tribunal looked retrospectively in determining that the claimant "remains wholly owned by its Canadian parent company, Pacific Rim [PRMC], a person of a non-CAFTA Party for the purpose of CAFTA Article 10.12.2."<sup>134</sup> In contrast, by accepting jurisdiction in *Plama* and *AMTO*, the tribunals implicitly accepted that the claimant is "owned or controlled" by a national of a contracting state. Due to the fact that in both the ECT and CAFTA the respondent must show that the claimant lacks both "substantial business activities" in a contracting state and proper "ownership or control" by a national of a contracting state,<sup>135</sup> the

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133. *Id.* § 68.

134. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.67.

135. *CAFTA*, *supra* note 25, at art. 10.12.2; *ECT*, *supra* note 15, art. 17(2).



tribunals essentially decided that the claimant satisfied both of the conditions needed to proceed to the merits.

The tribunals in *AMTO* and *Plama* examined current “ownership or control” as the determining factor for whether the respondent can deny substantive investment protection at the merits phase. Yet, these tribunals still must look retrospectively to make this determination. For example, both *Plama* and *AMTO* contain complex shareholding structures that must be deconstructed to discover who or what directly or indirectly “owns or controls” the claimant.<sup>136</sup> At the end of the analysis, both tribunals evaluate whether the claimants were “owned or controlled” by a contracting state at the time the DOB clause was invoked.<sup>137</sup>

Like the analysis on “substantial business activities,” both *Plama* and *AMTO* have consistent substantive interpretations of “ownership or control” with *Pacific Rim*, but such interpretation is distorted by the prospective/retrospective distinction. Both *Plama* and *AMTO* looked to see whether the claimant, and only the claimant, was “owned or controlled” by a national of a contracting state.<sup>138</sup> In *Plama* and *AMTO*, however, the claimant was the parent company.<sup>139</sup> The tribunals’ task, therefore, was to determine whether the claimant was “controlled” by nationals of a contracting state. Conversely, in *Pacific Rim*, the claimant was a subsidiary wholly owned by its Canadian parent company.<sup>140</sup> This explains why the *Plama* and *AMTO* tribunals looked to controlling shareholders and board members. Shares may have been held by various subsidiaries, but in these cases, the parent company was the claimant. In *Pacific Rim*, no further analysis of the parent company was necessary once it was established that the parent company was not the claimant, but in fact wholly owned and controlled the claimant. Furthermore, unlike in *Plama* and *AMTO*, the parent company in *Pacific Rim* was not comprised of subsidiaries, so it was an easier task for the *Pacific Rim* tribunal to identify whether the claimant belonged to a CAFTA contracting party.

While both tribunals concluded that a national of a contracting state did “own or control” the claimant, this determination should be made prior to assuming jurisdiction. If the outcome established that the claimant was not “owned or controlled” by a

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136. *Plama*, *supra* note 32, ¶¶ 83–91; *AMTO*, *supra* note 111, ¶¶ 66–67.

137. *Plama*, *supra* note 32, ¶ 91; *AMTO*, *supra* note 111, ¶ 67.

138. *Plama*, *supra* note 32, ¶ 83; *AMTO*, *supra* note 111, ¶ 66.

139. *Plama*, *supra* note 32, ¶ 83; *AMTO*, *supra* note 111, ¶ 66.

140. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶ 4.79.

national of the contracting state, the tribunal would spend valuable resources deciding a case that should have been terminated before the merits were ever addressed. Under the *Plama* and *AMTO* merits based interpretations, “the tribunal abdicates its responsibility to ensure that meritless claims are disposed of economically at the jurisdictional phase.”<sup>141</sup> Both “substantial business activities” and “ownership or control” must be determined during the jurisdictional phase to ensure arbitral efficiency and economy. If not, issues pertinent to whether the tribunal has jurisdiction will be improperly addressed during the merits phase of the arbitration. This will not only result in undue arbitration, but it also will result in frivolous claims that have no cause of action under the particular treaty used to assess the arbitral forum.

#### IV. THE CAFTA DENIAL OF BENEFITS CLAUSE PROVIDES A SOLUTION TO “TREATY SHOPPING”

Unlike the ECT cases discussed above, the *Pacific Rim* tribunal’s treatment of the CAFTA DOB clause provides an effective solution to “treaty shopping.” “Treaty shopping” occurs when a treaty is drafted or construed in such a manner that allows claimants to select as the “Investor” an existing company, or even create a new “shell” company in its investment structure, simply to benefit from treaty provisions.<sup>142</sup> If, like the *Plama* line of ECT cases suggests, the DOB clause cannot be a jurisdictional limitation on the investor’s consent, then investors will be encouraged to reap treaty benefits without any obligations. Tribunals will assume at the jurisdictional phase that the claimant satisfies the requirements of the DOB clause, thereby providing some treaty benefits when the claimant should actually be provided no such protection. While investment treaties are drafted to encourage and protect investors, these protections must be balanced with the interests of the host state.

By regarding the CAFTA DOB clause as a jurisdictional limitation to be applied retroactively, the *Pacific Rim* tribunal protected El Salvador from granting benefits to an entity that neither had “substantial business activities” in a contracting state nor was “owned or controlled” by Salvadoran nationals.<sup>143</sup> By finding

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141. *Chalker*, *supra* note 68, at 13.

142. ANDREW PAUL NEWCOMBE & LLUIS PARADELL, *LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT* 69 (2009).

143. *Pac Rim Jurisdiction Decision*, *supra* note 27, ¶¶ 4.63–4.82.

that Article 17(1) was not a jurisdictional issue, the *Plama* tribunal turns the purpose of a DOB clause on its head. It allows host states to be sued by investors who have no exercisable rights under a treaty. It also places host states in the precarious position of regulating investors without requiring the investors to be forthcoming about their nationalities. The *Plama* tribunal, therefore, “has created an impossible burden for regulators, especially in those poor and transition states that are still developing regulatory abilities.”<sup>144</sup>

The analysis in *Pacific Rim* successfully prevented a “shell company” from exercising rights and obtaining jurisdiction that it never legitimately possessed. Phrases such as “may refuse” and “reserves the right to refuse,” may be permissive but do not signify a prospective analysis. This is because it allows a host country to consistently assess whether particular investors have met the burden of proof of demonstrating treaty application. A host country’s denial of treaty benefits is “left to the discretion of the host State which chooses, according to its needs, the companies to which it denies or accords the benefits of the treaty.”<sup>145</sup> The denial of benefits is not automatic. By interpreting this language as granting a prospective effect to the denial of benefits, *Plama* robs the DOB clause of its true object and purpose: to prevent “treaty shopping.” After all, an investor would have little to lose if treaty protections could not be denied to past activities that were not legitimately made because the claimant was never eligible for treaty protection in the first place.

By acknowledging PRMC, and not US shareholders, as the true owner of Pac Rim, and by recognizing that any business activities in the US was conducted under the auspice of PRMC, the CAFTA DOB clause was given true effect. It signifies to investors, and particularly to parent companies, that “shell companies” cannot be created simply to provide treaty rights that the parent company would otherwise be without. There must be some legitimate connection between an investor and the treaty benefits and protections it seeks to utilize. While this decision is not binding on future CAFTA tribunals, it provides significant guidance if and when the CAFTA DOB clause is invoked in the future.

The *Pacific Rim* tribunal’s treatment of the DOB clause pro-

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144. *Chalker*, *supra* note 68, at 20.

145. SUZY H. NIKEMA, INT’L INST. FOR SUSTAINABLE DEV. (IISD), BEST PRACTICES DEFINITION OF INVESTOR, 13 (2012) *available at* [http://www.iisd.org/pdf/2012/best\\_practices\\_definition\\_of\\_investor.pdf](http://www.iisd.org/pdf/2012/best_practices_definition_of_investor.pdf).

vides the most effective solution to treaty shopping. While MFN clauses have been viewed as a solution to treaty shopping, MFN clauses do more to encourage “treaty shopping” than to prevent it. A MFN clause operates to “ensure that relevant parties treat each other in a manner at least as favourable as they treat third parties.”<sup>146</sup> In other words, “MFN clauses aim at counteracting discrimination between foreign investors with different nationalities.”<sup>147</sup> Hence, an MFN clause, unlike a DOB clause, does not identify who qualifies as an “investor.” Instead, an MFN clause merely ensures that a bona fide “investor” is provided the same treatment as compared to other “investors” under similar BITs. While the MFN clause may harmonize favorable treatment among investors, it is always possible to look to alternate treaties to find more favorable treatment for almost any substantive provision.<sup>148</sup> According to Essing:

The investor does not have to accept the application of disadvantageous provisions in the third party treaty imposed on him as a price for advantages in the course of balancing the investor’s interests with public policy concerns of the advantages of the third party treaty are incorporated in the basic treaty by virtue of the MFN clause.<sup>149</sup>

The MFN clause cannot be a viable solution to “treaty shopping” when the purpose of the MFN clause itself is to provide investors access to more favorable treatment under treaties to which they are not contracting parties. Therefore, it is essential that DOB clauses be carefully drafted and properly interpreted to prohibit the extension of “investor” protection to unwarranted parties in the first place. To properly act as a safeguard against “treaty shopping” the DOB clause analysis must be a jurisdictional analysis as demonstrated in *Pacific Rim*.

## V. CONCLUSION

This comment illustrates how *Pacific Rim*’s use of VCLT Articles 31 and 32 treaty interpretation principles creates an effective CAFTA DOB clause. Unlike the ECT, the CAFTA DOB clause

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146. RUDOLPH DOLZER & CHRISTOPHER SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 186 (Oxford Univ. Press 2008).

147. H. Essig, *Balancing Investors’ Interests and State Sovereignty: The ICSID-Decision on Jurisdiction Plama Consortium Ltd. v. Republic of Bulgaria*, 4:5 TDM 14 (Sept. 2007).

148. *Id.* at 25.

149. *Id.*

provides an effective solution to “treaty shopping” and creates a strong jurisdictional safeguard against investor abuse. While the *Pacific Rim* decision is not binding on future tribunals, it will likely be highly influential for both CAFTA and NAFTA DOB clause jurisprudence. *Pacific Rim* will also likely dissuade investors from using the United States as a safe haven for shell companies. Companies looking to “nationality shop” for the sake of investor protection will have to look elsewhere.

Tribunals must go beyond the ordinary meaning of a treaty when relying on the ordinary meaning alone leads to unreasonable and absurd results. Tribunals must interpret treaty provisions in a manner that gives them effect and abides by basic principles of statutory interpretation. Regardless of whether *Pacific Rim* would have been interpreted differently had CAFTA been worded in the same manner as the ECT, the *Pacific Rim* DOB analysis adheres to all the VCLT treaty interpretation principles. No subsection of VCLT Article 31 ranks superior to others. *Pacific Rim*’s analysis agrees with both the ordinary meaning of the DOB clause, and is clearly understood in the larger context of the treaty. While contracting parties may decide not to include a DOB clause in a treaty, when it is included, the DOB clause should limit the parties to those that can avail themselves of the treaty protection in accordance with its object and purpose. DOB clauses must be interpreted in a way that protects both investors and host states by providing a balanced assessment of which investors have assumed both the obligations and benefits of the treaty under which the investor requests arbitration.